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Budget Options After the Shutdown Agreement

Last week, Congress approved and the President signed a compromise agreement that ended the 16 day government shutdown and extended the federal government's debt limit. While Congress is now able to focus on other matters, all eyes will be on the outcome of the budget conference created by the shutdown agreement and the ultimate resolution to the funding the government for the remainder of Fiscal Year 2014 and the upcoming Fiscal Year 2015.

As we have learned in recent weeks, anything can happen in Washington, but the general view is that there are 4 potential scenarios, some more or less likely than the others.

First, remember that the shutdown agreement funds the government at \$986 billion for FY14 with a Continuing Resolution (CR) through January 15th and extends the debt ceiling through February 7th, leaving intact the ability of the Treasury Department to use "extraordinary measures" to meet the government's obligations beyond that date if necessary. The agreement also called for a budget conference to create a framework for spending, taxes, and entitlements, with a conference report due by December 13th. It is also important to recall that January 15th is when the next round of sequestration hits, with the impact falling more heavily on the Defense Department.

So, what are the potential budget options after the shutdown agreement?

The "Grand Bargain"

The Grand Bargain has been viewed as the holy grail of budget negotiations going back to at least 2011 when the *Budget Control Act* created the Joint Select Committee on Deficit Reduction (the "super committee") tasked with crafting a decadal deficit reduction plan. The failure of the super committee triggered the mandatory spending reductions of sequestration, totaling approximately \$1 trillion between Fiscal Year 2013 and Fiscal Year 2021.

A Grand Bargain would necessitate a compromise with Democrats agreeing to entitlement reform and Republicans agreeing to increased tax revenues. While there is some willingness in

the Democratic caucus to tackle entitlement reform, there are also many who would oppose any efforts to touch Social Security, Medicare, etc. Increased tax revenues would be a hard sell in the Republican caucus. Compromise from either side of the aisle on these issues might be difficult to achieve.

Perhaps the single most important reason that a Grand Bargain stands any chance is that it may be a way for President Obama to secure his legacy, similar to what President Clinton was able to accomplish during the 1990s in getting the nation's fiscal house in order. By agreeing to some entitlement reform, which the president has indicated he would support, and increasing tax revenues, the president may see a way to end or ease sequestration. If he is saddled with sequestration for the remainder of his presidency, it will be extremely difficult for him to make the types of investments that he says are necessary in areas such as infrastructure and education.

Conversely, one obstacle to a path forward on a Grand Bargain is that House Ways and Means Chairman Camp (R-MI) and Senate Finance Chairman Baucus (D-MT) continue to say they are focused on comprehensive tax reform. If a Grand Bargain is reached over the next several months, it may include some smaller tax reform measures, but nothing close to the comprehensive reform that they are seeking that will take much longer to negotiate. A Grand Bargain would likely take the wind out of the sails for comprehensive tax reform.

Although it is certainly still alive as a possible outcome, the difficulty in attaining this goal over the past several years, not to mention the limited time left before we reach the deadlines of the shutdown agreement, leave the Grand Bargain as a possible, but unlikely, outcome.

Another Government Shutdown

Although there may be some voices of support for another shutdown among the most conservative members of the Republican caucus, most Republicans appear to want to move forward from the recent situation and are not going to want to revisit it in just three months. Democrats, having fared better than the GOP in the recent shutdown, won't want to risk being blamed for a second shutdown. It has been 17 years since the last government shutdown, so, while it is certainly possible, another shutdown so soon after the recent situation has to be the least likely scenario.

Another Continuing Resolution (or Resolutions)

The budget conference has been charged with producing a budget resolution/conference report no later than December 13th, setting spending limits for the remainder of the current fiscal year. The late date of December 13th leaves very little time for the House and Senate Appropriations Committees to draft and Congress to pass a spending bill before January 15th when the current CR expires. Should the budget conference not produce a final budget resolution, or should the Appropriations Committees not be able to have an Omnibus appropriations bill ready by January 15, then we could see a CR covering the remainder of FY14 through September 30, 2014 or a series of short CRs as the House and Senate continue to seek a more permanent solution.

A Budget Conference Agreement & Omnibus Spending Bill

When House Republicans produced their Budget Resolution earlier this year, they marked to sequestration numbers, setting spending at \$967 billion for FY14 and \$995 billion for FY15. Senate Democrats marked their Budget Resolution at the higher levels of \$1.058 trillion for FY14 and \$1.086 trillion for FY15.

Depending on what the budget conference reports out, and assuming that Congress approves a conference report, we believe that the most likely scenario is going to be a meeting in the middle – with spending somewhere in the range of \$80 billion to \$100 billion over two years above the House’s sequestration numbers. This compromise would achieve the goal of easing the impact of sequestration, a goal for many Republicans concerned about defense spending, while appealing Democrats who feel that increased spending is necessary to shore up a still-shaky economy. This compromise would probably have to recognize that new revenues are off the table for Republicans, and that significant reforms to entitlements like CPI and Medicare are off the table for Democrats.

The sense among many Democrats is that if they give the Pentagon some relief on sequestration and do not raise revenues, then moderate Republicans will be more amenable to a higher spending level than in the original House-passed Budget Resolution.

However, this compromise on increased spending means that Congress would have to identify a way to offset the \$80-\$100 billion. The Farm Bill alone would account for \$27 billion in savings. The remaining savings would have to be achieved through an assortment of smaller items, such as pension reform, spectrum sales, etc. However, most of the increased spending would have to be achieved through offsets on mandatory spending.

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